OFFICE OF THE ATTORNEY GENERAL OF TEXAS
AUSTIN

GERALD C. MANN
ATTORNEY GENERAL

Hon. Frank D. Wear
Assistant Securities Commissioner
Secretary of State
Austin, Texas

Dear Sir:

Opinion No. O-1814
Re: Is the Century Life Insurance Company authorized, under the laws of Texas, to issue "surplus certificate bonds" with the terms and conditions as set out hereinafter?

Your letter of recent date requesting the opinion of this department touching the above matter, has been given our careful consideration.

The Century Life Insurance Company is an insurance corporation engaged in the business of selling life insurance in Texas under and by virtue of the provisions of Chapter 3, Title 78, Revised Civil Statutes of Texas, 1925, as amended. It desires to issue and sell to the public "surplus certificate bonds" containing the following terms and conditions:

"THIS CERTIFIES THAT _____ the holder hereof, has paid into the SURPLUS of the CENTURY LIFE INSURANCE COMPANY, the sum of _____ Dollars ($_____) and the Company hereby agrees to pay interest thereon at the rate of five per cent per annum to the holder hereof from date until this certificate is retired in accordance with its terms, interest payable on the 1st day of July of each year.

"This certificate, together with similar certificates, shall be retired in the order issued out of surplus of the Company in excess of $250,000. and/or from the proceeds of certain

endowment coupons contained in policies issued by the Co pany and assigned for that purpose.

"In accordance with unanimous resolution of the stockholders of the Century Life Insurance Company, it is agreed that no dividends shall be declared or paid on the capital stock of the Company until the principal of this certificate and all interest due under it shall have been retired and paid in full, and in event the Company should be liquidated the obligations under this certificate shall be prior, and superior claim to that of the stockholders.

"In accordance with the laws of the State of Texas the amount of this certificate together with the interest thereon shall be payable only out of the surplus of the Company after providing for all the reserves and other liabilities of the Company.

"This certificate is transferable only on the books of the Company in person or by duly authorized attorney upon its surrender properly endorsed.

"IN WITNESS WHEREOF, the Century Life Insurance Company has caused this certificate to be signed by its duly authorized officers and its corporate seal to be hereunto affixed this_____ day of _____, A. D. 19___.

_____ _____
Secretary President."

There is no express statutory authority for Chapter 3 Insurance Corporations to borrow money; neither is there any statutory prohibition against the exercise of such power. There is, of course, no statutory authorization for the issuance of these proposed surplus certificate bonds.

It is conceded, as a general proposition, that private corporations may, without express statutory authority, borrow money when necessary in the legitimate

ecurse of the corporate business. This rule would, it seems, likewise apply to an insurance corporation such as the Century Life Insurance Company.

We, therefore, concede, for the purposes of this opinion, that the Century Life Insurance Company has the power to borrow money when necessary in the legitimate course of its business, confining ourselves only to the question as to whether the proposed sale of such surplus certificate bonds would be a legitimate, lawful and authorized exercise of the general implied power to borrow money. On this question, there are no precedents in Texas.

The plan of issuing and selling to the public such surplus certificate bonds by the Century Life Insurance Company, whereby it may raise money, clearly is not the employment of the usual and commercial method of borrowing money. The transaction will not embrace an unequivocal obligation to return the property borrowed at regular intervals, or at a stated time; nor does it embrace a stated, or regular, or certain time for the payment of interest. It embraces only an obligation to repay the sums advanced out of the surplus of the company in excess of $250,000. "and/or from the proceeds of certain endowment coupons contained in policies issued by the company and assigned for that purpose", with the interest thereon payable only out of the surplus of the company. There is no power in the holders of such instruments to exact payment, either of principal and interest, at any stated time, or at any time, for that matter. The certificates vest in the owner a greater interest in the capital or property of the company, in case of liquidation, than the stockholder themselves possess; and the certificates further declare the repayment of the principal thereof with interest, when and if ever done, to be superior to the right of the stockholders to dividends. Furthermore, in the contract of subscription for such certificates, there appears this provision:

> "On completion of this subscription it is also agreed that there shall be delivered to me without further cost____shares of the capital stock of the Century Life Insurance Company, fully

> paid and non-assessable, which said stock has been deposited with the company for this purpose."

It is clear beyond any question that the transactions contemplated by the Century Life Insurance Company in the sales of these surplus certificate bonds are not "loans" and the company is not "borrowing" as these terms connote in their ordinary commercial and legal sense. In just what relation to the company the certificate holder would stand, in a legal sense, whether as a preferred stockholder, or as an annuity owner, or something else, is immaterial; suffice for this opinion, there will certainly not be created the usual debtor-creditor, borrower-lender, relation which is known and illustrated in ordinary commercial transactions wherein money is loaned and borrowed.

It is our considered opinion that the principles announced by Mr. Justices McKennan and Butler in the case of Taylor vs. Philadelphia and Reading Railway Company, et al, and McCalmont vs. Philadelphia and Reading Railway Company, et al, 7 Red. Rep. 386, correctly state the law applicable to the matter under consideration in this opinion.

At pp 390 and 391 in the above case, Mr. Justice McKennan says:

> "Whatever power the defendant has in the premises can only be found in its general authority to borrow money. Neither in the charter of the defendant, nor in the special act which authorizes it to sell bonds, which it may issue below par, is anything contained to legalize the contested proposition, unless it can be put on the footing of a loan. Has it then this character? I think plainly not. It does not propose to create the relation of debtor and creditor between the defendant and the subscribers. The money obtained by the defendant could not be regarded as borrowed, because that implies re-imbursement, and it is not demandable by the subscribers or payable by the defendant. It has not the essential and distinguishing qualities

of a loan. It contemplates a stipulation that the subscribers, in consideration of the sums paid-not lent-by them, shall be entitled to receive, in a remote and uncertain contingency, a portion of the defendant's earnings, to be measured by a certain rate per cent, upon three times the sums paid by them, and after that shall participate with the common shareholders in the division of the residuary earnings. By what allowable definition of a loan or borrowing such a transaction can be embraced I am at a loss to conceive. Nor will the fact that it is to be evidenced by the sealed writing of the defendant change its inherent character and bring it within the range of a power to which it is not otherwise referable.

"In one respect, and in one only, does the plan proposed resemble a loan, and that is in the result to be attained. They are both expedients for raising money, but the method of accomplishing this result is of the essence of the power of the corporation. If its employment has not explicit legal sanction it cannot be made available. * * * Authority to raise money by borrowing does not imply the use of another and different method of raising it, however well adapted to the end it may be. * * * "

At pp 392 and 393, in concurring, Mr. Justice Butler says:

"That the defendants have power to borrow money is not questioned, and could not be. The plaintiffs assert, however, that this is not a proposition to borrow money, but a scheme to sell stock. The defendants claim that it is strictly a proposition to borrow - conceding that, if it is not, but virtually is to sell stock, they have no lawful authority to carry it out. Thus a vital issue of law is sharply defined and presented. It is one that neither requires nor admits of extended discussion. Every admissible definition of the term borrow or loan, as applied to money and commercial transactions, embraces an obliga-

tion to return the property borrowed. A loan of money is universally understood to be the delivery of a certain sum to another, on contract for its return, generally with interest, as compensation for its detention and use. To call the payment of money to another, who is to receive and permanently retain it as his own, in consideration for an annual benefit or profit, a loan, would seem to be a plain misuse of language.

"There is no such thing known to commerce or transactions in money as an irredeemable loan in the sense here involved. Governments have issued obligations without provision or stipulation for repayment of the principal borrowed; but such obligations are redeemable at pleasure. Running, however, for an indefinite time, with no power in the holder to exact payment, they have come to be regarded as irredeemable, and an investment in them is, therefore, treated and described, not as a loan, but as the purchase of an annuity or stock. Aside, however, from the abstract considerations involved in defining the term borrow or loan, the corporate powers of the defendants to borrow money must be held to apply only to such methods of borrowing as fall within the ordinary sense of the term- as understood by the community, and illustrated in commercial transactions. Applying this test to the proposition here under consideration, it becomes plain that the transaction contemplated is not a loan. * * * * (Underscoring ours)

Further, from the note to the above case, at p. 395 we quote:

* * * * In the case of Kent v. Quicksilver Min. Co. 78 N.Y. 159, the company being in need of funds, the stockholders adopted a by-law providing that stockholders who should surrender their certificates and pay five dollars on each share of stock should be entitled to the same number of shares of preferred stock, which should be entitled to 7 per cent interest, to be

> paid out of the profits of the company, any surplus thereafter to be divided pro rata among common and preferred stockholders. The court held that it did not fall within the power to borrow money, and was ultra vires. Folger, J., says: 'It was not a borrowing. The idea of borrowing is not filled out unless there is in the agreement therefor a promise or understanding that what is borrowed will be repaid or returned.' Page 177. In these transactions, it is not by what name it is called, but what, in fact, the transaction is, that the courts consider. * * * "

The case of Synnott v. Tombstone Consolidated Mines Co., et al, 208 Fed. Rep. 251, involved bonds issued by a corporation by which it agreed to pay their face value with interest out of certain funds created from the net surplus earnings of the company and in the event of liquidation or dissolution, the obligation should attach to a l the funds and assets of the company, together with other provisions similar to the surplus certificate bonds under consideration herein. The court held that the instruments in question were not provable against the estate of the bankrupt corporation, for the reason that they created no fixed liability against it.

It is, therefore, our opinion that the general implied authority of the Century Life Insurance Company to borrow money would not legalize its proposed expedient for raising money; namely, the issuance and sale of surplus certificate bonds such as the sample which accompanied your letter.

As observed in the beginning of this opinion, the specific statutes of Texas relating to insurance corporations and particularly to those created under Chapter 3, Title 78, Revised Civil Statutes of Texas, 1925, as amended, do not expressly authorize such insurance companies to borrow money, nor do they prohibit the exercise of such power. It is significant, although not given controlling force in this opinion, that the legislature in enacting Chapter 7, Title 78, Revised Civil Statutes of Texas, 1925, pertaining to mutual life insurance companies, did specifically authorize advancements to such

insurance companies by any person in a manner similar to the purchase of the proposed surplus certificate bonds to be issued by the Century Life Insurance Company. This authorization is found in Article 4816, supra. The fact that the legislature deemed it necessary to expressly authorize such Chapter 7 companies to receive advancements in this manner, definitely indicates that it conceived such power to be non-existent in insurance corporations created under and by authority of the statutes theretofore enacted by it. Chapter 3, of course, was originally enacted in 1909. This consideration certainly gives emphasis to the position we have taken in this opinion; namely, that, conceding the power in an insurance corporation in Texas to borrow money, the further power to issue surplus certificate bonds, as contemplated by the Century Life Insurance Company, cannot be legally implied.

You are, therefore, respectfully advised that it is the opinion of this department that the Century Life Insurance Company of Fort Worth, Texas, is not authorized under the laws of Texas, to issue surplus certificate bonds with the terms and conditions, and in the manner contemplated, as set out in this opinion and in your letter.

Trusting that we have adequately answered your inquiry, we remain

Yours very truly

ATTORNEY GENERAL OF TEXAS

By Zollie C. Steakley
Zollie C. Steakley
Assistant

ZCS:ob

APPROVED JAN 26, 1940

Gerald C. Mann

ATTORNEY GENERAL OF TEXAS

APPROVED
OPINION
COMMITTEE
BY BWB
CHAIRMAN